United States Court of Appeals

for the Second Circuit

PETITIONER'S REPLY BRIEF

Original

To be argued by
JAY TOPKIS

76-4044

United States Court of Appeals

For the Second Circuit

BOC INTERNATIONAL LIMITED, f/k/a The British Oxygen Company Limited, BOC FINANCIAL CORPORATION, BOC HOLDINGS, LIMITED, and BRITISH OXYGEN INVESTMENTS, LIMITED,

Petitioners,

against

FEDERAL TRADE COMMISSION,

Respondent.

B P/S

On Petition for Review of and to Set Aside an Order of the Federal Trade Commission

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REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

INDUSTRIAL GASES

I

The Evidence Does Not Support the Conclusion that BOC Was Likely to Enter.

The Commission found that "there are substantial barriers for entry into the industrial gases business". Among other problems, a new entrant would face large capital costs and suffer cost disadvantages vis-a-vis established firms. (A878) The British Government, moreover, has correctly pointed out that foreign firms like BOC face numerous additional barriers which make entry still more difficult, a circumstance the Commission simply ignored. (U.K. brief ("br.") 18-21) The hearing record below is bare of evidence that BOC *intended* to enter, and it is devoid of evidence from which it may reasonably be concluded that BOC probably *would* have entered. Yet the Commission concluded that "there was a 'reasonable probability' that BOC would have eventually entered the U.S. industrial gases market . . . but for the acquisition of Airco." (A891)

The Commission's decision, we submit, is based on nothing more than speculation, often in the face of contrary

evidence. Indeed, as the British Government has demonstrated, such a subjective approach to Section 7—if permitted to stand—would erect a serious barrier to foreign investment in the United States. (U.K. br. 9-10, 30-33) The decision should be set aside.

A. The Record Does Not Permit the Conclusion that Entry Was Sufficiently Attractive to Make it Probable.

Since there is no evidence that BOC planned or intended to enter, the Commission attempts to argue that entry was so economically attractive that BOC would have been irresistably drawn to enter. (*See* FTC br. 29-39) And the Commission's brief begins from the premise that, at least as of 1970, the market was not sufficiently attractive to make new entry likely. (*See* FTC br. 29-33) It could hardly do otherwise in light of BOC's Perham-Greenfield report, which concluded in 1970 that there was "no case" for entering the U.S. gases industry.* (A5974)

The Commission's principal response is that market conditions changed between 1970 and 1973-74. (FTC br. 29-33) And in fact, prices of and demand for industrial gases did rise, as did those of almost all other basic industrial commodities.** But the critical element missing from the Com-

* The Commission's brief endeavors to undercut the significance of the report by asserting that "there is no documentation that BOC's top management adopted the report's recommendation." (FTC br. 30) This is misleading: the uncontradicted evidence was that the report was adopted by the chairman's committee of BOC, its board of directors, and an international advisory group within BOC. (A2463-64)

** During 1973 and early 1974, the nation in general experienced a sharp—and temporary—industrial capacity "crunch". *See generally* 60 *Federal Reserve Bulletin* 1-3 (1974); 61 *Federal Reserve Bulletin* 1, 5 (1975); 62 *Federal Reserve Bulletin* 71, 76 (1976); *Economic Report of the President* 43 (1974); *Economic Report of the President* 38-39 (1975); *Economic Report of the President* 211 (1976).

mission's case is any showing that the change in market conditions—which was expected to be and in fact was transitory (BOC br. 70-73, 27) —was such as to make entry by BOC a probability. There was absolutely no evidence whatever that if BOC or some other new entrant had invested X dollars in new capacity, it could reasonably have expected to capture Y percent of the market and earn any return on its investment. Hence, there was no basis for concluding that temporary changes of uncertain magnitude in market conditions were likely to attract entry.*

Hard evidence showing that entry would have been economically attractive would have been unusually important in this case, if such evidence existed. The barriers to entry —particularly capital cost and the cost disadvantage which a new entrant would suffer—concededly are very high. (*See* A878) And BOC, as a foreign company, faced additional barriers making entry still more difficult.** (U.K. br. 18-22) With entry so costly and difficult, it simply blinks reality to conclude—as the Commission did—that BOC was likely to enter the U.S. gases market without a scrap of evidence that entry would have made any economic sense.

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* Even the evidence about 1973 market conditions is conclusory. Despite the vague testimony that prices had "firmed" (A1318), there is no evidence as to what prices in fact were in 1973 or in prior years. And despite the talk of some shortages in some gases in some regions, the only quantitative evidence as to the extent of the shortages is that offered by BOC—which is that the shortages did not exceed one to two percent of capacity. (BOC br. 26) Moreover, even this conclusory evidence comes exclusively from competitors of Airco and BOC—whose testimony is inherently suspect as a matter of law. (BOC br. 80-82; U.K. br. 14-15)

** The Commission's brief waves aside the special barriers faced by foreign firms, arguing that L'Air Liquide, a French firm, entered in 1968. (FTC br. 72-73) But the Commission simply ignores the fact that the strategy pursued by L'Air Liquide—a rapid succession of substantial acquisitions—is no longer possible (BOC br. 59-60), at least not unless Airco is a permissible toehold acquisition. (U.K. br. 22-30; Point VII, *infra.*)

The Commission argues that to require hard economic evidence that entry would be an economically viable matter would be to "impose an impossible burden". (A828, A859) But the Commission is simply wrong. Hard economic data and analysis, as distinguished from the speculation which fills this record, has been a feature of the government's proof in other potential competition cases.

A prime example is *United States* v. *Penn-Olin Chemical Co.,* 378 U.S. 158 (1964). There the government sought to prove that Pennsalt and Olin Mathieson were likely entrants into the southeast sodium chlorate market but for their formation of the Penn-Olin joint venture. In order to demonstrate the likelihood that one or both of the firms would have entered, the government offered detailed financial analyses of the economics of building a new plant in the target market, the projected future demand for the product, and the effect of future price changes on the economics of entry.*

Similarly, in *United States* v. *Falstaff Brewing Corp.,* 410 U.S. 526 (1973), the government contended that Falstaff was a likely entrant into the northeast beer market but for its acquisition of an existing brewer. In support of its contention, the government offered a study, prepared by Arthur D. Little, Inc., which analyzed the market and concluded that entry was desirable and that de novo entry was economically preferable to entry by acquisition.** *Id.* at 529 n. 7.

And putting aside the government's practice in other cases, the Court doubtless is aware that private companies

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* Plaintiff's exhibits 82, 96B, and 100, record at 642-45, 653-68, 690-91, *Penn-Olin, supra,* 378 U.S. 158. (Copies of these materials have been lodged with the Clerk for the convenience of the Court.)

** Government exhibit 10, appendix at 536-58, *Falstaff Brewing Corp., supra,* 410 U.S. 526. (A copy has been lodged with the Clerk.)

routinely undertake such economic analyses in evaluating the possibility of expansion into new markets.* For example, this Court's opinion in *Missouri Portland Cement Co.* v. *Cargill, Inc.,* 498 F.2d 851 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974), describes Cargill's study of possible entry into the cement industry.

The Commission in this case was peculiarly well-situated to provide this kind of hard information and analysis if it would have supported its case. By total happenstance, the Commission had been conducting a full scale investigation of the industrial gases industry for almost a year before BOC acquired its Airco stock. (A40, A132-40, *passim*) In consequence, the Commission's staff economists were possessed of all the basic facts required to offer expert opinions on BOC's acquisition. But the Commission did not call experts.** It chose to rely on speculation and surmise rather than hard data and analysis.

The Commission's belated attempt to persuade the Court that the gases industry was increasingly profitable in 1973 (FTC br. 33-37) —an issue it did not address at trial—

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* The studies offered by the government in *Penn-Olin* and *Falstaff* had been prepared for the companies involved. This record furnishes other examples. BOC RX 58 is an analysis of the economic feasibility of entry into a regional merchant gases market prepared for United States Steel Corp. (A5866) Arthur D. Little, Inc., shortly prior to the hearing below, prepared a study of entry into this industry by acquisition of a foreign firm other than BOC. (A2826-30; BOC RX 235, A6002) And of course, BOC's Perham-Greenfield report is still another example.

** The Commission's failure to call its economists is understandable. Two staff economists filed affidavits in support of the Commission's application for a preliminary injunction. Affidavits of Robert O. Reck and Bernard L. Weinstein, FTC application for temporary restraining order, etc., *FTC* v. *British Oxygen Co.,* civil action no. 74-31 (D. Del. 1974). A significant part of what they told to the district court in Delaware is at odds with the position the Commission now takes in this proceeding. (BOC br. 29 n.*)

hardly remedies its failure of proof below. For one thing, profitability of existing companies, even if established, would not prove that a new entrant would be profitable. Not only do existing companies operate at lower cost than would a new entrant buying equipment at inflated prices (A878) —but the addition of new capacity by a new entrant might drive down prices and reverse any trend toward increased profitability. *See* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act,* 78 HARV. L. REV. 1313, 1381 n. 88 (1965). For another, even the extraordinary "evidence" relied upon by the Commission—principally a *Business Week* article which is not in the record—provides scant support for its conclusion.*

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* *Business Week* reported consolidated rates of return for several of the so-called gases companies. (FTC br. 33 and n. 20) But these are diversified companies and, as complaint counsel said below, "consolidated returns . . . provide no basis for determining the profitability of the industrial gas operations of the companies." (Cpt. counsel's reply to respondent's proposed findings of fact and conclusions of law 31 (Aug. 22, 1974)).

The FTC's claim that Airco's profitability doubled between 1969 and 1971 (FTC br. 34) is misleading due to the choice of a base year; the record shows a distinct "up-and-down" pattern. (A5386) Moreover, Airco's return on total capital invested in its gases business was below savings account level in all years. (*Ibid.*).

We note also that the Commission refuses to surrender the evidence on industry profitability that it does have, the data underlying BOC RX 254. (FTC br. 35-36) Although the Commission still insists that the underlying data understate profitability because return on investment was calculated without taking depreciation into account (*ibid.*), it has declined to make the data available to the Court. Indeed, the Commission has denied our Freedom of Information Act request for this data, among other things, and we have commenced suit in an effort to obtain it. *Paul, Weiss, Rifkind, Wharton & Garrison* v. *FTC,* CA-77-0071 (D. D.C. filed Jan. 13, 1977). It surely would violate a basic principle of due process simply to accept the Commission's word for what the data represent without permitting BOC's counsel to examine it.

B. De Novo Entry Was Not Shown to Be Commercially Feasible.

The Commission's essential response to our overwhelming proof that de novo entry would have made no economic sense is to assert that BOC could have entered on something less than a national scale. (FTC br. 39-41) But the Commission's argument does not carry the day.

First, while regional entry would surely be cheaper, there was no showing that regional entry would have made any more economic sense than national entry.

Second, two major premises of the Commission's decision were: (1) the nation as a whole is the proper geographic market (A872), and (2) entry by BOC would have a significant procompetitive effect *in that national market* (A901). It would be fundamentally inconsistent with these premises to conclude that BOC was likely to enter some unidentified regional market.

Third, the contention that entry was commercially feasible because BOC could bid on the construction of new plants (FTC br. 40-41) is nonsense. There was no evidence that this route—which BOC never tried to follow—would have been an economically practical means of entry.

Finally, the Commission misreads this Court's decision in *Missouri Portland Cement Co.* v. *Cargill, Inc., supra,* 498 F.2d 851, and distorts the record below. (FTC br. 41) *Missouri Portland* stands for the proposition that a firm should not be regarded as likely to make a de novo entry where the cost of doing so far exceeds the cost of entry by acquisition and where there is no evidence that de novo entry is "an attractive possibility". 498 F.2d at 863-64. That holding is fully applicable here because the Commission offered no proof below that de novo entry would have been commercially attractive and because the cost of de

novo entry into this capital intensive industry would be staggering.

The Commission tries to avoid *Missouri Portland* and the record facts here by asserting that "there is no dispute that BOC had the incentive to find means to enter the U.S. industrial gases market". (FTC br. 41) But incentive is likely to bring about attempt only if the attempt is feasible in dollars and cents. The record here shows that it was not.*

C. The Toehold Theory Was Not Made Out.

Analysis of the Commission's brief exposes the unwarranted extreme to which it would push the toehold theory.

First, the Commission now says that it did not find that Liquid Carbonic and Big Three were likely toehold candidates and, indeed, that our arguments concerning these firms are immaterial. (FTC br. 43 n. 28) Hence, we need speak no further about those firms.

Second, the Commission does not dispute our contention that acquisition of any of the smaller firms would be indistinguishable from de novo entry—because the remaining firms are so small and their equipment is often antiquated and uncompetitive. (BOC br. 55-59)

Third, the Commission's brief does not even contend that a toehold acquisition would have been economically attractive. Indeed, it emphasizes the Commission's finding that "the record does not establish whether [any of the small

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* The Commission goes to some length to suggest that BOC did not view entry in dollars and cents economic terms. (FTC br. 38-39) While BOC was interested in the United States for reasons in addition to the possibility of an immediate profit, there is no evidence that it would enter absent a reasonable likelihood of a satisfactory return on its investment. The evidence is to the contrary. (*See* A5973-89; A2483-86; A3328)

firms] would be good investments or bad investments." (FTC br. 42 n. 26)

The Commission's position therefore comes down to this: If there exist firms smaller than the acquired company, toehold entry must have been probable. After all, goes the Commission's argument, the acquiring company made one acquisition in the target market: if that route were barred, it probably would have acquired a smaller firm. And the Commission takes this position without any analysis of the size, technical proficiency, profitability, or availability of the smaller firms.*

The Commission's position on the toehold theory defies the real world. No sensible prediction can be made of whether a possible entrant would enter by acquiring a small firm without considering precisely the factors the Commission treats as immaterial. Indeed, this Court—and others which have dealt with this issue—properly have given the Commission short shrift on this point.**

In *Missouri Portland Cement Co., supra*, 498 F.2d 851, this Court carefully analyzed the merits and demerits of the proposed toeholds. In concluding that the toehold theory was inapplicable, Judge Friendly pointed to such factors as the technological problems making one firm unattractive, the limited limestone reserves and landlocked nature of another, and the long shipping distances facing still others.

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* A principled analysis, we submit, shows that Airco is a permissible toehold acquisition. (U.K. br. 22-30; Point VII, *infra*.)

** We are aware of only one case in which the Commission's theory has prevailed. *Kennecott Copper Corp.* v. *FTC*, 467 F.2d 67 (10th Cir. 1972), *cert. denied*, 416 U.S. 909 (1974). But as Judge Friendly has indicated, that decision—which has been criticized sharply on this point (Note, 86 HARV. L. REV. 772, 777 & n. 26 (1973))—is of dubious authority. *Missouri Portland Cement Co., supra*, 498 F.2d at 860 n. 14.

498 F.2d at 864-65. Thus, the Court carefully analyzed the attractiveness of toehold entry; it did not just assume that the existence of smaller firms sufficed.

More recently, the court in *United States* v. *Black & Decker Manufacturing Co.*, 1976-2 TRADE CAS. ¶ 61,033 (D. Md. 1976), also analyzed the toehold question in a manner fundamentally inconsistent with the Commission's position. In dismissing a Justice Department Section 7 case, the court began its toehold analysis by stating that "[i]nitially the purchase availablity of toeholds must be ascertained." *Id.* at 69,592. It then rejected all of the toehold companies proposed by the government on grounds including their poor financial condition, their unavailability for sale,* and their product and technological deficiencies. *Id.* at 69,592-94.

In addition to its theory that the existence of smaller firms is sufficient in itself, the Commission's brief—like the Commission's decision—argues that BOC probably would have made a toehold acquisition because L'Air Liquide acquired American Cryogenics in 1968. (FTC br. 43) But both brief and opinion simply ignore the evidence which proves that the circumstances of 1968 no longer exist—and, therefore, that L'Air Liquide's 1968 strategy would be impossible today. (BOC br. 59-60)

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* While this Court has ample grounds on which to dispose of the toehold theory without treating the question of availability, we note that the Commission's brief does not respond to our showing that we were barred from cross-examining witnesses from these small firms on their profitability and the terms, if any, on which they might be "available" for acquisition. (BOC br. 61) In light of this patently erroneous ruling at trial, reliance on conclusory testimony that some of these firms were or might become "available" would be improper. As one of these witnesses testified, any company is "available" for the right price. (A1726) Without more detailed evidence as to a witness's meaning in using the term "available", there is simply no basis for concluding that acquisition of a firm is a practical alternative.

D. The Documents Support BOC's Position—Not the Commission's.

The Commission's brief asserts that "documentary evidence" shows that BOC "was a probable entrant". (FTC br. 43 *et seq.*) The Commission tries to read the documents as showing that "BOC set about to expand into the U.S. industrial gases market in the summer of 1969." (FTC br. 44) This conclusion is a gross distortion of the record and, indeed, is inconsistent with the Commission's findings below.*

The documents are quite clear. In August 1969, BOC decided to look for "profitable opportunity" to expand in North America. (A3965) All of the contemporaneous documents show clearly that BOC was interested in an extraordinary range of different businesses, not only industrial gases. (*E.g.*, A3967-69; A3971-4001; A4002-04) Indeed, a staff paper prepared in August 1969 did not even list industrial gases as a possible area for expansion in North America. (A3976-77)

In late 1969, BOC decided to conduct the search for American opportunity in disciplined fashion, studying possible product areas one at a time. The industrial gases industry was studied first because BOC was most experienced in that area. (A4140)

The study, of course, was the Perham-Greenfield report, which found in February 1970 that there was "no case for entering the USA industrial gas market. . . ." (A5974)

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* As we will show, the evidence demonstrates that in 1969 BOC decided to *study* the U.S. gases industry for several purposes. The study was the Perham-Greenfield report. BOC did not *decide* to enter the U.S. gases business in 1969 or at any other time. The Commission recognized this when it vacated the ALJ's finding that "[b]y 1969, BOC had made a definite decision to enter the U.S. industrial gases market . . . ." (F 95, A770; A856)

Significantly, the Commission points to not a single study, strategy paper, or other similar document after Perham-Greenfield which suggests that BOC was likely to enter the U.S. gases market.

Trying to deal with this lack of evidence, the Commission refers to the episodes involving Burdett of Cleveland and Burdett of Norristown. (FTC br. 45-47) The Commission argues that these incidents show that BOC did not accept the Perham-Greenfield conclusion. We will not repeat the detailed discussion of these episodes in our main brief. (BOC br. 36-38) The salient point for present purposes is this: BOC did not approach either Burdett; each Burdett approached BOC. Neither incident evidences any BOC intention to enter the U.S. gases business nor any belief that entry was so attractive as to make it likely. Indeed, in turning down Burdett of Norristown, BOC explicitly rejected as impractical the toehold strategy which the Commission now argues BOC would "probably" have followed but for Airco.

Finally, the Commission asserts that it correctly gave little weight to the testimony of BOC's witnesses because the documents were inconsistent with their testimony. (FTC br. 47-48) This is nothing but ritualistic incantation —BOC's documents and testimony are entirely consistent. They show that BOC carefully considered the possibility of entering, rejected it as commercially impractical, and budgeted no funds for entry. (BOC br. 35-38) There is no contrary evidence in this record.*

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* The Commission's brief argues also that management testimony should be rejected because, says the Commission, management testimony proved unreliable in cases involving Humble Oil and Bethlehem Steel. (FTC br. 48-49) This is incredible. The case tried below involved BOC's acquisition of an interest in Airco, not the activities of Humble Oil or Bethlehem Steel.

II

The Commission Applied an Incorrect Standard in Determining that BOC Was an Actual Potential Entrant.

In our main brief, we argued that the Commission erred in classifying BOC as an actual potential entrant on the basis of its conclusion that "there was a 'reasonable probability' that BOC would have eventually entered the U.S. industrial gases market . . . ." (A891) The uncertainties of the "actual potential entrant" theory are so great—greater than in other Section 7 cases—that the statutory standard of a reasonable likelihood of substantial anticompetitive effects is not satisfied unless entry is considerably more certain than "reasonably probable". *See* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 Harv. L. Rev. 1313, 1383-84 (1965). Hence, a firm should not be classified as an actual potential entrant unless there is clear and unequivocal proof that the firm in fact would

have entered the market by another means in the imminent future.* (BOC br. 76-82)

The Commission's brief does not deny that actual potential entrant cases involve substantially greater uncertainty than other Section 7 cases. Indeed, it does not even meet our argument on the merits. It simply asserts that a reasonable likelihood that BOC eventually would have entered is sufficient. It asserts that its position has been approved by the Supreme Court in *United States* v. *Marine Bancorporation*, 418 U.S. 602 (1974), and *United States* v. *Penn-Olin Chemical Co.*, 378 U.S. 158 (1964), as well as by the district court in *United States* v. *Marine Bancorporation*, 1973-1 TRADE CAS. ¶ 74,496 (W.D. Wash. 1973), *aff'd*, 418 U.S. 602 (1974).** (FTC br. 56-58) But the Commission's treatment of *Marine Bancorporation* is hardly candid, and *Penn-Olin* does not support its position.

Contrary to the Commission's argument, the Supreme Court's opinion in *Marine Bancorporation* did not even assume that a reasonable probability of entry would suffice. The references in the Commission's brief*** are simply to the Supreme Court's paraphrase of the district court's findings. As a matter of fact, the Supreme Court suggested that there would have to be "unequivocal proof" that entry

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* We assume here for purposes of discussion that the elimination of future competition is "lessening" of competition—an anti-competitive effect within the meaning of the Act. In Point III we endeavor to show that it is not.

** The Commission's brief cites also *Ekco Products Co.* v. *FTC*, 347 F.2d 745 (7th Cir. 1965). *Ekco*, however, merely relied on language in *Penn-Olin*, dealt with below, and made no independent analysis of this issue. *Id.* at 752-53. Hence, there is no need to discuss *Ekco* apart from *Penn-Olin*.

*** The Commission's brief refers the reader to pages 616 and 617 of 418 U.S.

would have occurred absent the acquisition *if* the "actual potential entrant" theory were valid. (BOC br. 79-80)

The district court's findings in *Marine Bancorporation* did speak in terms of reasonable probability of entry. *United States* v. *Marine Bancorporation, supra,* 1973-1 TRADE CAS. ¶ 74,496, at 94,246. But the district court made no analysis of this question. It simply adopted without change the defendant's proposed findings, and was taken to task by the Supreme Court for having done so. *Marine Bancorporation, supra,* 418 U.S. at 615-16 & n. 13. Thus, the only person who assumed that a reasonable probability of entry would suffice was the attorney who drafted the findings in *Marine Bancorporation.*

The Commission's brief relies also on the *Penn-Olin* Court's remand for consideration of the issue whether there was a "reasonable probability" that one firm would have entered the market while the other would have hovered on the "fringe". 378 U.S. at 175-76. Several factors deprive the Court's language there of persuasive effect in this case.

First, and most important, *Penn-Olin* was not an "actual potential entrant" case.* The Court's concern was that the joint venture there at issue eliminated both Pennsalt and Olin Mathieson as firms exerting a procompetitive influence from the fringe of the market; absent the joint venture, one might have entered while the other continued to exert a fringe effect. 378 U.S. at 173, 175-76. If there was a reasonable probability that this would have occurred, there was a reasonable probability that the joint venture lessened competition.** Here, in contrast, this equation between

* The Commission's opinion concedes as much. (A892 n. 22)

** The Court assumed that the Government could show that the removal of both firms from the fringe of the market lessened competition. 378 U.S. at 176.

probability of entry and probability of anticompetitive effect is invalid. (BOC br. 76-77)

Second, the issue of the appropriate standard of likelihood of entry was not before the Court. Both sides agreed that a "reasonable probability" test was proper on the facts of *Penn-Olin.**

Finally, it is worth noting that the doctrine of potential competition is relatively new. The first reference by the Supreme Court to potential competition occurred in *United States* v. *El Paso Natural Gas Co.,* 376 U.S. 651, which was decided in 1964. *Marine Bancorporation, supra,* 418 U.S. at 623. *Penn-Olin* was only the second potential competition case to reach the Court. Since those early days the doctrine has undergone considerable development, reaching maturity perhaps only with *United States* v. *Falstaff Brewing Co.,* 410 U.S. 526 (1973). This circumstance would warrant caution in attaching undue importance to language in early cases like *Penn-Olin* in any event. But here there is particular reason to do so. It was only in *Marine Bancorporation, supra,* 418 U.S. 602—decided ten years after *Penn-Olin*—that the Court first clearly stated that the Government would have to prove *both* that entry would be sufficiently likely to occur absent the challenged acquisition *and* that entry probably would have substantial procompetitive effects, even if the "actual potential entrant" theory were valid. 418 U.S. at 633, 638-39. Prior to that decision, one might easily have jumped to the conclusion that proof of some degree of likelihood of entry absent the acquisition was the only element of the cause of action. Given that assumption—now shown to have been erroneous by *Marine Bancorporation*—a reasonable probability of entry standard could have been regarded as consistent with Section 7. In light of *Marine Bancorporation,* however, it is insufficient.

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* *See* Brief for Appellants at 28, Brief for Appellees at 10, *Penn-Olin, supra,* 378 U.S. 158.

III

The Question Reserved in Falstaff and Marine Bancorporation Should Be Resolved in BOC's Favor.

Like so many other aspects of the decision below and the Commission's brief, the Commission's treatment of the question reserved in *United States* v. *Falstaff Brewing Corp.,* 410 U.S. 526 (1973), and *United States* v. *Marine Bancorporation,* 418 U.S. 602 (1974), is superficial.

The question reserved in *Falstaff* was clearly put by Mr. Justice White—whether:

> "a merger that will leave competition in the marketplace exactly as it was, neither hurt nor helped, and that is challengeable under § 7 only on grounds that the company could, but did not, enter *de novo* or through 'toe-hold' acquisition and that there is less competition than there would have been had entry been in such a manner [is unlawful]." 410 U.S. at 537

Putting it another way, the crucial issue is the frame of reference for determining whether an acquisition is likely substantially to lessen competition. Does Section 7 contemplate that the competitive effect of the acquisition be deter-

mined by comparing the probable post-merger level of competition with the pre-merger level of competition? Or does it permit comparison of (a) the probable future level of competition assuming the merger is permitted with (b) the probable future level of competition assuming the merger is proscribed?

If the relevant comparison is the pre-existing level of competition versus the probable future level, the "actual potential entrant" theory is insufficient as a matter of law, and the complaint here must be dismissed. This is so because in a pure "actual potential entrant" case such as this, the acquisition leaves "competition in the marketplace exactly as it was, neither hurt nor helped . . . ." * The complaint is merely that the acquiring company did not act so as to increase competition.

If, on the other hand, the relevant comparison is between two hypothetical future levels of competition—that which would obtain if the acquisition were permitted versus that which would obtain if the acquisition were barred—an acquisition eliminating an "actual potential entrant" might be proscribed, assuming all of the other statutory prerequisites were satisfied.

Thus, the critical inquiry is which analytical framework the statute contemplates. The Commission's brief does not address this issue. It merely invokes the familiar principle that Section 7 requires a prediction of future competitive conditions, but begs the question of the standard against which those future conditions are to be compared. (FTC br. 53)

The language of Section 7 suggests strongly that the relevant comparison is whether the probable level of com-

* *Falstaff, supra,* 410 U.S. at 537.

petition after the acquisition is likely to be substantially lower than the preexisting level of competition. The statute bars acquisitions the effect of which "may be substantially to lessen competition . . .." And the use of the word "lessen" is significant. "Lessen" connotes a progressive reduction or diminution, here a reduction in the level of competition.* It therefore implies a comparison of the future with the past. Thus, the common understanding of the statutory language indicates that Congress intended a comparison between the pre-acquisition and probable post-acquisition levels of competition.

Early Clayton Act cases show that the Supreme Court construed Section 7 as requiring precisely the "before-and-after" analysis advocated here.** *International Shoe Co.* v. *FTC*, 280 U.S. 291 (1930), illustrates the point. There the Court reversed a decision upholding an FTC finding that an acquisition of one shoe company by another violated Section 7. It did so on the ground that the acquiring and acquired companies were not significant competitors before the acquisition;*** hence, the acquisition could not substan-

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* *See* The Oxford English Dictionary 209 (1943); Webster's New International Dictionary of the English Language 1418 (2d ed. unabr. 1939); The Random House Dictionary of the English Language 822 (unabr. ed. 1971).

** The same is true under the Sherman Act. *E.g., Chicago Board of Trade* v. *United States*, 246 U.S. 231, 238 (1918) (Brandeis, J.). The Sherman Act cases are relevant here because a purpose of Section 7 was to permit intervention in a process which would lead to a trade restraint of the sort dealt with by the Sherman Act via a series of acquisitions. H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8 (1949); Federal Trade Commission, *Report on Corporate Mergers and Acquisitions* 157 (1955).

*** As originally enacted, Section 7 required the government to show a lessening of competition between the acquiring and acquired firms. Act of Oct. 15, 1914, ch. 323, § 7, 38 Stat. 730, 731-32. (BOC br. 86)

tially lessen competition between them. The Court's opinion explicitly adopted the "before-and-after" analysis:

> "Mere acquisition by one corporation of the stock of a competitor, even though it result in some lessening of competition, is not forbidden; the act deals only with such acquisitions as probably will result in lessening competition to a substantial degree, *Standard Fashion Co.* v. *Magrane-Houston Co.*, 258 U.S. 346, 357; that is to say, to such a degree as will injuriously affect the public. *Obviously, such acquisition will not produce the forbidden result if there be no pre-existing substantial competition to be affected;* for the public interest is not concerned in the lessening of competition, which, to begin with, is itself without real substance." 280 U.S. at 298 (emphasis supplied).

The acquiring-acquired test was eliminated from Section 7 by the Celler-Kefauver Act.* (BOC br. 86-87) The purpose of that amendment, however, was not to change the "before-and-after" test. As the Commission itself has recognized, the purpose was to extend Section 7 to acquisitions which threaten substantially to lessen any competition, not only competition between the acquired and acquiring firms. Federal Trade Commission, *Report on Corporate Mergers and Acquisitions* 154-55 (1955).** It was intended, for example, to extend the statute to cover vertical acquisitions—acquisitions in which the acquiring and acquired companies by definition are not competitors. *E.g.*, *Brown Shoe Co.* v. *United States,* 370 U.S. 294, 317 (1962); *United States* v. *Bethlehem Steel Corp.*, 168 F. Supp. 576, 582-83

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* Act of Dec. 29, 1950, ch. 1184, 64 Stat. 1125.

** *See generally Brown Shoe Co.* v. *United States*, *supra*, 370 U.S. at 317 n. 30; H.R. Rep. No. 1191, 81st Cong., 1st Sess. 11 (1949).

(S.D.N.Y. 1958) (Weinfeld, *J.*). Hence, the Celler-Kefauver Act did not change the relevant frame of analysis.

The legislative history also shows that Congress intended the "before-and-after" analysis. The House report on the Celler-Kefauver Act listed examples of the types of anti-competitive effects Section 7 was intended to reach:

> "elimination in whole or in material part of the competitive activity of an enterprise which has been a substantial factor in competition, increase in the relative size of the enterprise making the acquisition to such a point that its advantage over its competitors threatens to be decisive, undue reduction in the number of competing enterprises, or establishment of relationships between buyers and sellers which deprive their rivals of a fair opportunity to compete." H.R. Rep. No. 1191, 81st Cong., 1st Sess. 8 (1949)

And in every example, the acquisition threatens to reduce the level of competition to a point below that which existed previously.

The Commission's brief studiously ignores both the language and, for the most part, the history of Section 7. Similarly, it does not respond to our contention that judicial extension of the Clayton Act to embrace the "actual potential entrant" theory would be improper, both because such a legislative function is reserved to the Congress and because application of the "actual potential entrant" theory involves such speculation that the courts ought not to reach out for such a task. (BOC br. 88-90) Hence, the Commission has provided no persuasive reason to hold that the "actual potential entrant" theory states a claim under Section 7.

The authorities cited on behalf of the Commission do not warrant a contrary conclusion. Suffice it to say that the

Commission's assertion that *United States* v. *Penn-Olin Chemical Co.,* 378 U.S. 158 (1964), sanctioned the "actual potential entrant" theory (FTC br. 51, n. 36) doubtless would come as a surprise to the Supreme Court, which has expressly noted that *Penn-Olin* did not decide the issue. *Falstaff, supra,* 410 U.S. at 537-38. We have already pointed out that the post-*Falstaff* decisions relied upon by the Commission offer no satisfactory basis for resolving the reserved question in the Commission's favor. (BOC br. 90-91) And the pre-*Falstaff* decisions cited in the Commission's brief, which are of dubious validity in light of *Falstaff* and *Marine Bancorporation,* made no analysis of the question presented here. At best, they assumed the point at issue.*

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* All of the cases were decided principally or exclusively on other grounds.

The principal basis of the Commission's decision in *Ekco Products Co.,* 65 F.T.C. 1163 (1964), *aff'd,* 347 F.2d 745 (7th Cir. 1965), was that Ekco's acquisition of the much smaller McClintock Company—which already had a monopoly in the relevant market—would entrench McClintock. 65 F.T.C. at 1217-20. Indeed, it specifically limited its holding to "the particular, and perhaps unique, circumstances of the case . . . ." *Id.* at 1220. The Seventh Circuit affirmed on the same ground, 347 F.2d at 753, and the comments of both the Commission and the court on potential competition simply assumed the question here at issue and were unnecessary to the result. *Kennecott* and *Wilson Sporting Goods* were based principally on the entrenchment and "fringe effect" theories and at most merely assumed the point here at issue in dicta. *Kennecott Copper Corp.,* 78 F.T.C. 744, 923-25 (1971), *aff'd,* 467 F.2d 67, 78 (10th Cir. 1972), *cert. denied,* 416 U.S. 909 (1974); *United States* v. *Wilson Sporting Goods Co.,* 288 F. Supp. 543, 556, 561-63 (N.D. Ill. 1968). *Standard Oil* was decided principally on traditional vertical acquisition criteria, as the acquiring company was a customer of the acquired company. It too assumed the point here at issue in dictum. *United States* v. *Standard Oil Co. (New Jersey),* 253 F. Supp. 196, 213-16, 224-27 (D. N.J. 1966). And *Schlitz* was decided primarily on horizontal merger grounds, as Schlitz and the acquired companies were substantial direct competitors prior to the acquisitions. *United States* v. *Jos. Schlitz Brewing Co.,* 253 F. Supp. 129 (N.D. Calif.), *aff'd without opinion,* 385 U.S. 37 (1966).

Finally, we note the Commission's contention that Section 7 should be interpreted to preserve the possibility of deconcentration of oligopolistic markets. (FTC br. 54) This assertion—which is supported by no more than a dictum from a traditional horizontal merger case—assumes the very point which the Supreme Court reserved in both *Falstaff* and *Marine Bancorporation.* The inescapable fact is that there is no evidence that Congress had any such intention in enacting the Clayton Act or the Celler-Kefauver Act.*

In the last analysis, the Commission here asks the Court to resolve the reserved question on the basis of cliches. A principled approach to this problem, we submit, can yield but one conclusion: Section 7 does not comprehend the "actual potential entrant" theory. As Judge Timbers said, in the district court, in rejecting another government effort to broaden Section 7 by construction rather than legislation:

> "The Court declines the government's invitation to indulge in an expanded reading of the statutory language and holds that the statute means just what it says . . . .
>
> "Whatever may be the merits of the arguments as a matter of social and economic policy in favor of, or opposed to, [the] standard [urged by the government], that is beyond the power of the Court to adjudicate . . . . [I]f that standard is to be changed, it is fundamental under our system of government that any decision to change the standard be made by the Congress and not the courts." *United States* v. *International Telephone and Telegraph Corp.,* 324 F. Supp. 19, 54 (D. Conn. 1970), *appeal dismissed,* 404 U.S. 801 (1972).

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* *See generally* H.R. REP. No. 1191, 81st Cong., 1st Sess. (1949); S. REP. No. 1775, 81st Cong., 2d Sess. (1950); S. REP. No. 698, 63d Cong., 2d Sess. (1914).

IV

There Was No Showing That Entry by BOC Would Have Been Likely to Have Substantial Procompetitive Effects.

In *United States* v. *Marine Bancorporation*, 418 U.S. 602 (1974), the Supreme Court held that one of the prerequisites which would have to be established in an "actual potential entrant" case, *if* the theory be valid, is that entry would "offer a substantial likelihood of ultimately producing deconcentration of [the target] market or other significant procompetitive effects." 418 U.S. at 633. The Commission's only response to our showing that the Commission made no such finding and, indeed, that there was no evidence upon which such a finding could have been based (BOC br. 120-25), is to distort the record.

The Commission's brief states that: "The Commission found that entry by BOC by internal growth or its equivalent would be important to the industrial gases industry." (FTC br. 59) This of course is not true: the Commission made no such finding. Instead, the Commission found that BOC had failed to prove the contrary. (A901) And since the point of our position, not to mention the Supreme Court's decision in *Marine Bancorporation*, is that the

government bears the burden of proving that entry in fact would produce "deconcentration of [the target] market or other significant procompetitive effects", the Commission's brief simply fails to meet the issue.*

The Commission's brief does argue that there was evidence below that the gases industry was characterized by oligopolistic behavior. (FTC br. 60) This contention, however, is inaccurate, insufficient, and is not properly before the Court.

First, the Commission asserts that one may assume that new entry would have a substantial procompetitive effect, if the target market is oligopolistic. The Commission cites no authority for this proposition, and for good reason. The effect of new entry into an oligopoly depends on how both the new entrant and the existing competitors react. If, for example, an industry is characterized by collusive price leadership, and a new entrant—particularly a firm entering by a toehold acquisition—elects to follow the leader, there will be no procompetitive effect at all. Moreover, the Commission forgets its notion that BOC could and would have entered on a regional basis. (A887-88) If, as the Commission concluded, this is a nationwide market and if BOC entered on a regional basis, one surely may not assume that the entry would have substantial

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* The Commission relies on *United States* v. *Phillips Petroleum Co.*, 367 F. Supp. 1226 (C.D. Cal. 1973), *aff'd without opinion*, 418 U.S. 906 (1974), for the proposition that "[i]t must necessarily be assumed" that entry would have substantial procompetitive effects. (FTC br. 61) But *Phillips Petroleum* is simply inconsistent with *Marine Bancorporation* on this point. And it is grossly distinguishable from this case.

procompetitive effects in the national market even if the assumption be valid for some regional entry.

Second, the Commission's claim that the gases industry is characterized by oligopolistic behavior is unsupported.* But that is beside the point because the Commission's contention is insufficient as a matter of law. As the Supreme Court held in *Marine Bancorporation*, the doctrine of potential competition applies only to concentrated, oligopolistic industries. 418 U.S. at 630-31. And yet the Court held that, even where the doctrine applies, the government must prove that entry probably would have substantial procompetitive effects. It necessarily follows, therefore,

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* The Commission relies on two scraps of evidence: (1) two 1969 statements attributed to industry executives to the effect that they believed Union Carbide would soon raise prices and that others would follow and (2) a September 1973 statement of another industry executive to the effect that the three main gases companies "no longer encroach in each other's area of domination." (FTC br. 60) As to the claim of price leadership, the Commission relies solely on statements as to future expectations. It neither refers to the evidence of record on this point nor offers evidence of actual price leadership. In fact, the record shows intense price competition in the industry and refutes the price leadership claim. The Perham-Greenfield report, for example, is filled with references to intense price competition (A5974, A5548, A5553, A5544) and quotes one industry executive as follows: "Union Carbide attempted to be price leaders in 1966/7 but were badly undercut and lost substantial market share which caused UCC to retaliate to hold their position." (A5584) Moreover, "parallel pricing" occurs in competitive as well as oligopolistic industries. Someone has to make the first price increase when demand is increasing, and others may be expected to follow. Markham, *The Nature and Significance of Price Leadership*, 41 AM. ECON. REV. 891, 896-901 (1951).

Nor does the second statement relied upon bear out the Commission's position. Certainly in a period of uncommonly high demand such as September 1973, one would expect that firms would concentrate on servicing their existing customers rather than on competing for the customers of other companies. This would be as true in a competitive market as in any other, as would the fact that prices rise when demand increases.

that proof of oligopolistic behavior would not alone permit the assumption that new entry would have substantial procompetitive effects.

Finally, the argument now advanced by the Commission is nothing more than a *post hoc* effort to justify the Commission's action below. In assuming—rather than demanding proof—that entry would have been substantially procompetitive, the Commission did not rely on the argument now advanced by its appellate counsel. And the Commission's decision may not be sustained on a ground upon which the Commission did not itself rely. *E.g., SEC* v. *Chenery Corp.*, 318 U.S. 80, 92 (1943); *FTC* v. *Sperry & Hutchinson Co.,* 405 U.S. 233, 246-49 (1972).

V

The "Fringe Effect" Theory Was Not Made Out.

As noted in our principal brief, the Commission vacated as unsupported the ALJ's finding that BOC exerted a procompetitive influence on the industrial gases industry as a perceived potential entrant on the fringe. (BOC br. 8; A879 n. 8) The Commission therefore specifically rejected reliance on the perceived potential entrant or "fringe effect" theory in this case.

Both the Commission's brief and its opinion, however, state that BOC, had it not acquired an interest in Airco, might some day have exerted such a fringe effect. (A880; FTC br. 59)

As noted in our main brief, this remark does not appear to have been a ground of the Commission's decision. (BOC br. 9 n.*) In any event, it would provide no basis for sustaining the order under review. There was no evidence below to support the Commission's statement. Moreover, no court, so far as we are aware, ever has suggested that the potential competition doctrine goes so far as to bar an acquisition because of a "possibility", to use the Commission's word, that the acquiring company otherwise might become a perceived potential entrant. As Mr. Justice Marshall has suggested, such an extension of the doctrine could not be squared with Section 7, which deals with probabilities, not "ephemeral possibilities." *Falstaff Brewing Co., supra,* 410 U.S. at 560 n. 15 (concurring); *accord, Brown Shoe Co.* v. *United States, supra,* 370 U.S. at 323 (1962).

VI

Potential Competition from BOC Is Unimportant to this Industry

A. The Threat of Upstream Integration by Customers Makes Concentration and Potential Competition Unimportant.

We have produced evidence and have argued that the threat of upstream integration makes potential competition from BOC unimportant in the industrial gases industry. Certainly the threat of upstream integration by customers keeps prices on tonnage supply contracts highly competitive —the industry's bidding practices make this inevitable. Indeed, the Commission conceded as much below. (BOC br. 95-96) And uncontradicted testimony of the director of Stanford Research Institute's Center for Chemical Industry Economic Studies was that the threat of upstream integration by tonnage customers ensures competitive pricing in the merchant market as well.* (A2945-48)

* The fact that vertically integrated tonnage users presently sell tc the merchant market via distributors rather than direct (FTC br. 63) is immaterial. Some of the large gases companies make much of their sales in the same manner. (*E.g.*, A1843) And the effect on prices and competition is the same—more supply means lower prices, assuming constant demand.

The Commission answers by obscuring the critical facts.

The Commission contends that "only a few customers are large enough to back-integrate economically in industrial gases." (FTC br. 62) But the evidence is to the contrary.* In fact, virtually any tonnage customer by definition is large enough to back-integrate economically. As the Commission's brief states: "Tonnage refers to the supply to customers whose demand at a particular location is sufficient to justify the construction of a plant at or near the customer's facility, which is devoted entirely or primarily to providing that customer with a gases product delivered through a pipeline." (FTC br. 14)

The fact that upstream integration is a viable (and often chosen) alternative for tonnage users, and therefore limits prices in both the tonnage and merchant markets, means that competition in the sale of atmospheric gases and hydrogen—which together accounted for 68% of all gases shipments by primary producers in 1972 (A871-72; A5213, A5209, A5212, A5216)—takes place under this serious practical constraint. Even if the gases companies might otherwise have the power to price above competitive levels (which the Commission did not establish), they would be prevented from exercising it in the major part of the business.

* For example, a Union Carbide executive called by the Commission testified that many firms in the steel, chemical and petroleum industries already produce various industrial gases, noting that "this is not so sophisticated a process." (A1200-08) Indeed, the record shows that substantial shares of the oxygen, nitrogen and hydrogen produced in the United States are produced by vertically integrated users. (BOC br. 23)

B. The Industrial Gases Industry Is Not Sufficiently Concentrated to Apply the Potential Competition Doctrine.

By its silence, the Commission has conceded that, if the value of captive production of industrial gases and shipments of gases by all producers were included in the universe of industrial gases production, the industrial gases industry would not be sufficiently concentrated to warrant application of the doctrine of potential competition. (*See* BOC br. 106-12) The Commission argues only that, in computing concentration, it properly excluded the value of captive production and properly used the value of shipments by primary producers of industrial gases rather than the value of shipments of all producers. (FTC br. 64-69)

The heart of the Commission's position is the assertion that captive production "never reaches the open market" and is not sold "*in competition* with industrial gases firms . . . ." (FTC br. 65) (emphasis in original) But a moment's reflection shows that this contention is misleading and, in any event, without merit.

The inaccuracy lies in the assumption that captive production does not compete with industrial gases companies. Every cubic foot of gas that is captively produced is a cubic foot of gas that is not sold by an industrial gases company, as every captive plant is the manifestation of a decision by the user not to enter into a tonnage supply contract with a gases company. (BOC br. 100, 95-96) Captive production therefore represents the failure of the gases companies to compete successfully for the business.

The Commission's argument, moreover, is inconsistent with its treatment of gases companies' tonnage production. While gases produced in captive plants are not sold in the open market, they are no different from gases pro-

duced in gases-company-owned tonnage plants, which are committed by long-term contracts to serve customers who, after the contracts are signed, cannot turn to alternative suppliers. Since the Commission included tonnage gases produced by gases companies in computing concentration, it should have included captive production also.

Given these circumstances, the Commission's position provides no answer whatever to Judge Learned Hand's reasoning in *Alcoa*. The purpose of measuring concentration and market shares is to determine in a rough way whether a firm or firms has market power—the ability to control the market. Captive production by users reduces the demand from, and is beyond the control of, other producers. It therefore limits the power of other producers over the market and must be considered in determining concentration and market shares.* *United States* v. *Aluminum Co. of America,* 148 F.2d 416, 424-25 (2d Cir. 1945). (BOC br. 101-03)

Nor has the Commission justified its use of shipments by primary producers rather than shipments by all producers. The gases in question here are those which are produced in plants the "primary product" of which is not industrial

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* The district court cases cited by the Commission (FTC br. 66), not binding here, do not support the Commission's position. *United States* v. *Greater Buffalo Press, Inc.*, 327 F. Supp. 305 (W.D.N.Y. 1970), *rev'd on other grounds,* 402 U.S. 549 (1971), did recognize "independent color comic supplement printing" as a market distinct from "in-house" printing. But even the Commission recognizes that it did so "because of cost savings inherent in printing supplements on a high volume basis" (FTC br. 66) rather than in-house. Captive (or in-house) production of color comic supplements therefore was not a competitive alternative to purchasing from independent suppliers and, in consequence, it would have made no sense to include both in the same market. 327 F. Supp. at 307-08. Here, on the other hand, captive production is an ever present and often chosen alternative which even the Commission concedes exerted a limiting effect on the market. (A901)

gases. In view of the Commission's concession that "[g]enerally, such gases are produced for the manufacturer's own use . . ." (FTC br. 67), precisely the same reasoning applicable to captive production requires the use of shipments by all producers in the market universe.

In conclusion, we note the Commission's claim that concentration in the gases industry has increased since 1967. (FTC br. 59 & n. 61) The statement is inaccurate. The figures relied upon come from the Initial Decision, which compared Census Bureau data from 1967 with the ALJ's own concentration calculation for 1972. (A760) As the ALJ conceded, the 1972 data were not collected on the same basis as the 1967 data. (A760 n. 2) The comparison therefore is invalid.

In fact, there has been a steady, albeit decreasing, trend to deconcentration in this industry since 1954. Top four concentration dropped from 77% to 65% between 1954 and 1972.*

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* The calculation of concentration figures was the subject of much debate before the Commission. Attached as Annex A are pages 13 through 16 of the reply brief of BOC respondents before the Commission, which contain the basis for the concentration figures cited in the text.

VII

Airco Was a Permissible Toehold Acquisition.

The British Government has argued in its *amicus curiae* brief—as we argued below—that Airco was a permissible toehold acquisition for BOC. (U.K. br. 22-30). Rather than burden the Court unnecessarily, we here adopt by reference the argument advanced on behalf of the British Government as well as our own contentions below on this point. (A525-26; appeal brief of BOC respondents 51 n.*)

The Commission's principal response to this contention is to assert that BOC waived this argument below. (FTC br. 74) Indeed, the Commission's brief attempts to justify the Commission's failure to deal with this issue on that ground. But the Commission's brief is not consistent with the record.

Early in the hearing before the ALJ, BOC did state "that AIRCO is nobody's toehold." (A1833; *see also* A1918) A short time later, this Court decided *Missouri Portland Cement Co.* v. *Cargill Inc.*, 498 F.2d 851 (2d Cir.), *cert. denied,* 419 U.S. 883 (1974). There the Court suggested that very substantial firms might be considered toe-

* A copy of BOC's brief below is attached to BOC's motion for leave to file oversized brief, filed with this Court on June 3, 1976.

holds in some circumstances, perhaps even a firm ranking second in a market if the largest firm has a very large market share. 498 F.2d at 858 n. 10.

Missouri Portland came down on June 10, 1974. Two days later—while the hearing before the ALJ was still under way—counsel for BOC gave the ALJ a copy of the decision and said:

> "The case is indeed interesting in that it causes me to realize that it is the thinking of the Second Circuit that a company so sizable as Airco might be a toehold, [*sic*] I hadn't realized that before, but I am always ready to learn from my betters, particularly when they happen to be sitting on appellate courts." (A2865)

From that point onward, the contention that Airco was a permissible toehold acquisition always has been in this case. BOC argued it in its proposed findings and conclusions before the ALJ. (A525-26) Complaint counsel responded to the contention on the merits before the ALJ. (Complaint counsel's reply to respondents' proposed findings of fact and conclusions of law 24-26 (filed Aug. 22, 1974)) BOC urged the point on appeal to the Commission. (Appeal brief of BOC respondents 51 n.)* Counsel supporting the complaint responded on the merits before the Commission. (Answering brief of counsel supporting the complaint 43 (filed Apr. 7, 1975))

Notwithstanding the contentions of the parties, and the undisputed showing that BOC's acquisition of its Airco stock is procompetitive (U.K. br. 28-30), the Commission simply ignored the issue.

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* Note * p. 35, *supra*.

MEDICAL EQUIPMENT

We turn now to the tail of the dog: the Commission's finding that BOC's acquisition violated Section 7 with respect to three tiny medical equipment product lines—anesthesia face masks, anesthesia vaporizers and anesthesia machines.

These matters are so trifling that they scarcely call for discussion: in any reasonable universe, if the Commission loses on industrial gases, BOC's acquisition can scarcely be prohibited because of some remotely conceivable mischief in the face mask business—face masks being about as significant in economic terms as tongue depressors.

The real significance of the medical equipment issues is the commentary they offer on how justice is purported to be administered in the Federal Trade Commission of the United States.

I

The Medical Equipment Case Should Be Dismissed Since It Is Based on a Theory which the Commission Disavowed.

The Commission's brief does not seriously dispute the three essential elements of our argument on this point: (1) the market theories upon which the Commission relied were disclaimed by complaint counsel and were not litigated before the ALJ or the Commission; (2) the Commission may not consider theories which were not litigated; and (3) where an appellate body finds that a lower tribunal's decision is based on a theory which was disclaimed by the prevailing party, the proper appellate remedy is dismissal. (BOC br. 126-31)

In light of these concessions, little more need be said. And so we deal with the Commission's arguments in summary fashion.

The Commission argues that BOC has failed to demonstrate the nature of the case it would have proved had the "markets" found by the Commission been at issue from the start. (FTC br. 78-81) But its contention is frivolous. It ignores altogether the fact that the Commission specifically disavowed reliance on the theory on which it ultimately

based its decision. And it is tantamount to arguing that a criminal defendant imprisoned and told of the charges only after the fact is not entitled to be released until he proves his innocence. In any event, although it is not our burden to make such a showing, it is abundantly clear that BOC would have approached the hearing below in an entirely different manner and would have offered different evidence had the "markets" now relied upon been alleged in the first place. Among other things, we would have attacked the "market" definitions* and the Commission's evidence on "market" share and size, and offered additional proof on the competitive performance and prospects of the "markets", including the influence of potential entrants.** Certainly the existence of these "markets" and the competi-

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* It goes virtually without saying that BOC did not, as the Commission now argues (FTC br. 79-80), concede in substance that the three products in question were "markets." Our discussion of competitive overlap—which relied on the Commission's concession that the market alleged was all inhalation anesthetic equipment and accessories—was intended to show only that, even on assumptions most favorable to the Commission, this acquisition would not have any significant competitive impact. And of course, even if each of these products is a "market", we had no opportunity to address the issue of competitive effect.

** By way of illustration only, evidence in this record suggests that Airco's and BOC's anesthesia machines should not be included in the same product market, as there are structural differences making Airco machines competitive primarily among U.S.-trained physicians and BOC machines competitive primarily among UK-trained physicians. (*See* A2124) Indeed, the Commission found that a doctor trained on an Airco machine will most commonly continue to purchase Airco machines and not other types, while a doctor trained on a BOC machine will typically purchase only BOC machines. (F 147, A796; A858) Since the "market" at issue during the trial was all inhalation anesthestic equipment and accessories, this distinction was not of great significance and we did not pursue it fully. But had we been on notice that the alleged "market" was anesthesia machines alone, we might well have done so.

Similarly, if the markets had been limited to these three products, we might well have pursued accurate market data, an almost insurmountable task for the full range of inhalation anesthetic equipment and accessories.

tive effects of BOC's acquisition on them are not proper subjects for judicial notice.

The Commission suggests also that, although it based its decision on unlitigated theories, BOC is precluded from pressing the issue because it did not seek reconsideration below. (FTC br. 80 n. 61) This contention too is without merit. Section 10(c) of the Administrative Procedure Act, 5 U.S.C. § 704, specifically provides in pertinent part that "agency action is final for purposes of [judicial review] whether or not there has been presented . . . an applicatilon for . . . any form of reconsideration . . . ." Indeed, the Sixth Circuit simply ignored a somewhat similar suggestion in vacating the Commission's decision in *Bendix Corp.*, 77 F.T.C. 731 (1970).* And in none of the other cases establishing the principle that the Commission may not base its decisions on unlitigated theories did the Commission even assert that the respondent's failure to petition for reconsideration precluded it from raising the issue in the courts of appeals.** BOC was under no obligation to ask the Commission to reconsider its decision before seeking relief in this Court.***

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* *Compare Bendix Corp.* v. *FTC*, 450 F.2d 534 (6th Cir. 1971), *with* Brief for Respondent at 104, *Bendix Corp.* v. *FTC, supra.*

** Brief for Respondent, *Stanley Works* v. *FTC*, 469 F.2d 498 (2d Cir. 1972), *cert. denied*, 412 U.S. 928 (1973); Brief for Respondent, *Rodale Press, Inc.* v. *FTC*, 407 F.2d 1252 (D.C. Cir. 1968).

*** One further point should be noted. The Commission cites *United States* v. *Continental Can Co.*, 378 U.S. 441, 457 (1964), for the proposition that a court can uphold a "*prima facie* showing of a line of commerce not pressed before." (FTC br. 81) As the Commission concedes, that case only upheld a *prima facie* showing in a case which was remanded for further proceedings. Mr. Justice Goldberg noted in his concurring opinion: "I wish to make it clear, however, that, as I read the opinion of the Court, the Court does not purport finally

(footnote continued on following page)

II

The Evidence in this Record Does Not Support a Finding of Violation of Section 7.

The Commission's brief fails to dispute a crucial fact: This record does not support findings that anesthesia face masks, vaporizers and machines are relevant product markets. Nor does the Commission's brief take issue with our contention that the *ex cathedra* "finding" that these are relevant product markets is a violation of Section 8(b) of the Administrative Procedure Act.*

Passing the failure to prove relevant markets, the Commission's arguments concerning the competitive effects of BOC's acquisition cannot stand.

The Commission argues that the statistics relied upon to prove shares of these "markets" are as accurate as they

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to decide the determinative line of commerce. Since the District Court 'dismissed the complaint at the close of the Government's case,' *ante,* at p. 444, upon remand it will be open to the defendants not only to rebut the *prima facie* inference that metal and glass containers may be considered together as a line of commerce but also to prove that plastic or other containers in fact compete with metal and glass to such an extent that as a matter of 'competitive reality' they must be considered as part of the determinative line of commerce." *Id.* at 466.

* 5 U.S.C. § 557(c)(3).

need to be—although data were not obtained from all producers. The Commission would justify this conclusion on the theory that the figure for total sales of all inhalation anesthetic equipment and accessories derived from the subpoena returns was close to the estimates of some industry witnesses. But there are no estimates in this record confirming the universe figures for the unlitigated "markets" relied upon by the Commission. The estimates referred to were for inhalation anesthetic equipment and accessories generally. Moreover, industry witnesses' estimates of the total inhalation anesthetic equipment and accessories "market" varied by over 50%, were admittedly ill-informed, were based on widely differing definitions of that "market", and are not a proper basis for determining market size. (BOC br. 133 n. 1, A626-28, A664-68)

Even if the statistics were reliable, the Commission's decision could not properly be based on statistics alone. The Commission cites the "presumptive rule of illegality" set forth in *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 363 (1963). Whatever the current status of that rule—and its validity surely is in doubt—the Supreme Court made it clear in *United States* v. *General Dynamics Corp.*, 415 U.S. 486, 498 (1974), that a Section 7 case cannot be proved solely by serving a subpoena for sales data and introducing the returns into evidence: "only a further examination of the particular market—its structure, history, and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger." *General Dynamics Corp., supra*, 415 U.S. at 498, *quoting Brown Shoe Co., supra*, 370 U.S. at 322 n. 38.

* * *

The Commission's exclusive reliance on inadequate statistics in its effort to attribute anticompetitive effects to BOC's acquisition on the anesthesia face masks, vaporizers

and machines "markets" is symptomatic of the fact that these "markets" were specifically disavowed and therefore never litigated. In light of the failure of proof, as well as the express disclaimer, the medical equipment part of the complaint should be dismissed.

RELIEF

A concluding word concerning relief.

We submit that there is no basis for sustaining the Commission's conclusion that Section 7 was violated either with respect to industrial gases or any type of medical equipment. We note, however, lest silence be taken as a waiver, that a violation of Section 7 in any or all of the medical equipment lines would not alone justify affirmance of the order requiring BOC to divest its interest in Airco.

The combined sales of BOC and Airco in the three medical equipment lines here at issue total—according to the Commission—just over \$5 million. (A906) This amounts to less than 0.4% of their combined 1973 sales of \$1,350,000,000. (*See* A867)

Complete, effective relief in the medical area could be accomplished easily by divestiture of BOC's subsidiaries, Harris Lake and Fraser Sweatman, Inc. And both the courts and the Commission have long recognized that such limited partial divestiture is the appropriate remedy where a large acquisition would violate Section 7 solely by virtue of a small competitive overlap. *See, e.g., FTC* v. *PepsiCo, Inc.*, 477 F.2d 24, 29 (2d Cir. 1973); *United States* v. *Reed Roller Bit Co.*, 274 F. Supp. 573 (W.D. Okla. 1967); *Warner Lambert Co.*, [1973-1976 Transfer Binder] Trade Reg. Rep. ¶ 21,141, at 21,032 (FTC 1976); *Scovill Manufacturing Co.*, 53 F.T.C. 260, 263 (1956) (order approving consent de-

cree). *See also Brown Shoe Co.* v. *United States, supra,* 370 U.S. at 337 n. 65.

Divestiture, after all, is a harsh remedy, and "it is not to be used indiscriminately, without regard to . . . whether other effective methods, less harsh, are available." *Timken Roller Bearing Co:* v. *United States,* 341 U.S. 593, 603 (1951) (Reed, J., concurring).

Accordingly, in the event the Court were to find a violation of Section 7 solely in the medical equipment area, it should modify the Commission's order to require divestiture by BOC of Fraser Sweatman, Inc. and Harris Lake, rather than BOC's interest in Airco.*

Conclusion

The Commission, we submit, has failed utterly to prove any of the factual prerequisites to consideration of the "actual potential entrant" theory.

And if this case establishes anything, it establishes that the "actual potential entrant" theory is nothing more than a euphemism for guesswork. As one commentator has said in advocating the abandonment of the potential competition doctrine: "The root problem is the impossibility of developing simple, workable rules of illegality in this area; and without such rules the enforcement of the antitrust laws tends to degenerate into a costly exercise in judicial [or administrative] whim." **

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* Section 11(c) of the Clayton Act, 15 U.S.C. § 21(c), specifically empowers this Court "to make and enter a decree affirming, *modifying,* or setting aside the order of the commission . . ." (emphasis supplied).

** Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Doctrines,* 75 Colum. L. Rev. 282, 323 (1975). *See also* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act,* 78 Harv. L. Rev. 1313, 1383-84 (1965).

This Court should not expand the potential competition doctrine to embrace the "actual potential entrant" theory because there are no workable rules for administering it and because the theory itself goes beyond the language of the statute and the Congressional purpose.

The petition for review should be granted in all respects and the Commission's order should be set aside.

Dated: January 17, 1977

Respectfully submitted,

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Annex A
Excerpt from Reply Brief of BOC Respondents
Before the Commission, April 21, 1975

II

Would Entry by BOC Have Been Likely Substantially to Improve Competition?

Even if complaint counsel had proved that BOC was likely to enter the U.S. gases industry but for its acquisition of an interest in Airco, they would have been only half way home. They still would have had to prove that entry by BOC would have been likely substantially to improve competition. *E.g., United States* v. *Marine Bancorporation*, 418 U.S. 602, 633, 638-39 (1974). There is absolutely no evidence to support any such conclusion. Indeed, one is almost forced to conclude that complaint counsel deliberately avoided offering proof on this issue:

Item: Although they repeatedly point to L'Air Liquide's entry via a series of acquisitions from 1968 through 1972, complaint counsel made no attempt to show that entry by the world's largest industrial gases company improved competition in the industry. In fact, complaint counsel cite "the acquisition program of Liquid Air" as proving a "trend toward concentration". (CCAB 25; F 66).

Item: Complaint counsel called no expert witnesses on this (or any other) issue. Thus, there is not even an economist's opinion as to the likely effects of entry.

Item: Complaint counsel did not ask their industry witnesses—the competitors of Airco and BOC—what they would have been likely to do had BOC entered the U.S. *de novo* or via a toehold.

Instead of pointing to proof, complaint counsel make much of our statement that existing U.S. gases companies would be likely to retaliate against BOC entry—counsel suggest that such retaliation would be procompetitive. (CCAB 46-47) Not at all—retaliation does not necessarily improve competition. American firms bent on maintaining their market shares might engage in practices which are hardly procompetitive—price discrimination, predatory pricing, coercing distributors and customers into entering into long-term contracts, tying agreements, and a host of other stratagems.

As we have seen, complaint counsel's burden was to demonstrate that actual entry by BOC would have been likely to have procompetitive effects. *Marine Bancorporation, supra*, 418 U.S. at 633, 638-39. This record contains no proof whatsoever that such an entry would be more likely to help than hurt competition. *See id.* at 638-39.

There being no proof, complaint counsel offer instead an image of an increasingly concentrated, uncompetitive industry. Even if the

image they put forward were accurate, it would be immaterial. No matter how concentrated or uncompetitive an industry may be, complaint counsel must still prove that new entry would be likely substantially to improve competition. *Marine Bancorporation, supra,* 418 U.S. at 633, 638-39. This burden they did not bear.

And so we might just pass over complaint counsel's discussion of concentration trends, price competition, profitability, etc. But we will cite one typical example to suggest the unreliable nature of complaint counsel's assertions—their effort to show that there is a trend toward concentration in the gases industry. (CCAB 6, 25-26)

Discussing the concentration trend evidence, complaint counsel take several different reports prepared by the Census Bureau on different statistical bases, connect them only by the magic incantation "Census says", and then choose only those data which suit their purpose, irrespective of whether the reports are fairly comparable with one another or are collected on a consistent basis. Moreover, complaint counsel do not even mention the Census Bureau report upon which we rely: United States Bureau of the Census, Census of Manufactures, 1967, Special Report Series: Concentration Ratios in Manufacturing, Part 2: Product Class Concentration Ratios, MC67(S)-2.2.

So there can be no misunderstanding at all, we reproduce here the relevant excerpt from that report:*

SR2-38 CONCENTRATION RATIOS — MANUFACTURES-SUMMARY

Table 6. Percent of Value of Shipments of Each Class of Products Accounted for by the Largest Companies: 1967 Compared With 1963, 1958, and 1954—*Continued*

[Certain Footnotes Omitted]

Code	Class of Products and Year		Value of shipments[2] Total (million dollars)	Percent accounted for by— 4 largest companies	8 largest companies	20 largest companies	50 largest companies
2813	Industrial gases	1967	543.4	65	79	90	96
		1963	389.6	71	83	92	97
		1958	262.6	78	84	91	96
		1954	195.4	77	83	90	(NA)

2Represents for each product class or group the total value shipped by all producers in all industries.

* See Appendix B to our reply brief below.

Thus, this Census Bureau compilation shows that from 1954 through 1967 the "top four concentration ratio" for industrial gases dropped from 77 percent to 65 percent and the top eight dropped from 83 percent to 79 percent.

The 1972 concentration ratios are missing from this table, but they are not difficult to compute. The Judge below correctly found that the total value of shipments of industrial gases in 1972 by the four and eight largest companies, respectively, were $414 million and $514 million. (F 63-64) He also correctly found that the total value of shipments of industrial gases by all producers was $649 million in 1972. (F 68) Use of these data result in four and eight concentration ratios in 1972 of 64 percent and 79 percent. (F 62) Hence, there plainly has been a trend to deconcentration since 1954 —from 77 percent to 64 percent for the top four, and from 83 percent to 79 percent for the top eight. In recent years, the trend has flattened somewhat—but it has never moved toward increased concentration.

Even the Census data referred to in complaint counsel's brief confirm this deconcentration trend. We reproduce below the relevant portion of that exhibit (BOC RX 72) as well:*

CONCENTRATION RATIOS 9-21

TABLE 5. Percent of Value of Shipments Accounted for by the Largest Companies in Each Manufacturing Industry: 1967 and Earlier Years—*Continued*

[Certain Footnotes Omitted]

Code	Industry and year		Companies (number)	*Value of shipments*[3] Total (million dollars)	percent accounted for by— 4 largest companies	8 largest companies	20 largest companies	50 largest companies	Primary product specialization ratio (percent)	Coverage ratio (percent)
2813	Industrial gases	1967	113	588.7	67	84	95	99	96	89
		1966	(NA)	549.7	72	88	(NA)	(NA)	(NA)	(NA)
		1963	104	425.4	72	86	95	99	98	87
		1958	111	232.0	79	88	94	98	97	84
		1954	101	167.7	84	88	93	(NA)	99	84
		1947	69	93.5	83	88	94	(NA)	100	84
		1935	(NA)	(NA)	79	87	(NA)	(NA)	(NA)	(NA)

[3]Value of shipments figures are not completely comparable between the years 1963-67 and prior years. They include for all establishments classified in the industry (a) value of products primary to the industry, (b) value of all secondary products which are primary to other industries, (c) value of miscellaneous receipts such as receipts for contract and commission work on materials owned by others, scrap, salable refuse, repairs, etc., and (d) value of resales—i.e., products resold in same condition as bought. In 1958 and prior years value of resales was excluded from value of shipments.

* The difference between the first figures cited in the text—the product class concentration ratios—and those in BOC RX 72 is simple. The first show

(footnote continued on next page)

While there is no evidence in the record from which 1972 concentration ratios may be computed on a basis consistent with those for earlier years,* these data at least show a trend to deconcentration from 1954 through 1967.

Hence, no matter how you view it—so long as you view the data fairly—there is a trend to deconcentration in this industry.

The question with which we began this section was whether complaint counsel have shown that entry by BOC would be likely substantially to improve competition. We have seen that there is literally no evidence from which any such conclusion may be drawn. One may speculate, but one might just as readily guess that entry by BOC would have anticompetitive effects as companies already on the scene used improper tactics to preserve market shares. Finally, complaint counsel's effort to substitute the claim that this is a highly concentrated, uncompetitive industry for proof of likely procompetitive effects of entry, which would be insufficient in law in any event (*infra*, Point III), falls flat for lack of record support.

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the portion of the total value of shipments of industrial gases *by all producers in all industries* that was accounted for by the four and eight largest firms. The second show the portion of the total value of shipments of industrial gases and a variety of other miscellaneous items *by establishments classified in the industrial gases industry* accounted for for the four and eight largest firms. (BOC RX 72F n.3) For a discussion of the differences between these two measures, see SINGER, ANTITRUST ECONOMICS 156-58 (1968).

* Complaint counsel's contention that concentration rose between 1967 and 1972 is based on a comparison of 1972 figures calculated from evidence in the hearing record with the Census Bureau figures shown above, which appear in BOC RX 72. (CCAB 21) As the Initial Decision concedes and as we carefully explained in our reply brief below, the two sets of figures are not computed on the same basis. (F 65 n.2, BOC RB 42-48). The universe figures used by complaint counsel and those used by the Census Bureau in BOC RX 72 are different. Therefore they may not properly be compared with one another.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

NAN C. MASTERS, being sworn, says:

1. I am not a party to this action, am over the age of 18 years, and reside at 340 East 80th Street, New York, New York 10021.

2. On January 17, 1977, I served two copies of the attached Reply Brief For Petitioners upon the following at the addresses designated by them for that purpose:

Jerold D. Cummins, Esq.
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3. Said service was made by depositing true copies thereof, enclosed in postpaid properly addressed wrappers, in an official depository under the care and custody of the United States Postal Service within the State of New York.

Nan C. Masters
Nan C. Masters

Sworn to before me this
17th day of January 1977

Dorothy A. Cox

DOROTHY A. COX
Notary Public, State of New York
No. 41-5841125
Qualified in Queens County
Commission Expires March 30, 1978